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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 1487

ARMSTRONG, JONES & CO. AND THOMAS W. ITIN,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1–11) is reported at 421 F. 2d 359. The findings and opinion of the Securities and Exchange Commission (Pet. App. A15–40) and the Commission's opinion denying rehearing (Pet. App. 41–47) are not yet reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A48–49) was entered on January 23, 1970. On April 27, 1970, Mr. Justice Stewart granted a timely request to extend the time for petitioning for a writ of certiorari to May 2, 1970. The petition was filed on April 27,

1970. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether substantial evidence supports the Commission's findings that petitioners violated several provisions of the federal securities laws.

2. Whether it was proper for the Commission to refuse to furnish petitioners with the names and prehearing statements of prospective witnesses prior to the hearing and, instead, to make such statements available only after the witnesses had completed direct testimony.

3. Whether the court of appeals correctly held that the sanctions imposed were within the Commission's discretion.

STATUTES AND RULES INVOLVED

Sections 3(a)(11), 5 (a) and (c) and 17(a) of the Securities Act of 1933, and Sections 10(b), 15(c)(1) and 17(a) of the Securities Exchange Act of 1934, respectively 15 U.S.C. 77c(a)(11), e(a), e(c), q(a), and 78j(b), o(c)(1) and q(a), and the pertinent rules under both statutes are set forth in the appendix, *infra,* pp. 13–17.

STATEMENT

The petition seeks review of the affirmance of an order of the Commission revoking the broker-dealer registration of petitioner Armstrong, Jones & Company ("registrant"), expelling it from membership in the National Association of Securities Dealers, Inc., and the Detroit Stock Exchange and barring its president, petitioner Itin, from association with any broker-

dealer for one year (and permitting his reassociation with a broker-dealer thereafter, upon appropriate showing, subject to adequate training and supervision). The order also unconditionally barred Rene F. Campeau, registrant's executive vice president, sales manager and director, from association with any broker-dealer and censured E. Keith Owens, who was one of registrant's principal stockholders and board chairman of Alexander Hamilton Life Insurance Company—whose stock offering was involved in the case.

The court of appeals held that the record contains substantial evidence to support the Commission's findings that (1) registrant and Itin willfully violated the registration provisions of the Securities Act of 1933 in the sale of shares of Hamilton Life; (2) registrant, willfully aided and abetted by Itin and Campeau, willfully violated the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 in the offer and sale of shares of Hamilton Life by means of extravagant and unwarranted price predictions by Campeau and various salesmen of registrant and without disclosure that registrant and Hamilton Life were under common control; and (3) registrant, willfully aided and abetted by Itin, willfully violated the same antifraud provisions, as well as the record-keeping provisions of the Securities Exchange Act, in its sale of stock of Windsor Raceway Holdings, Limited, by sending confirmations of sale to customers who had not in fact ordered the stock. On the basis of these findings, the Commission concluded: "The extensive violations by registrant and Itin demonstrate gross indifference to

the requirements of the securities laws and are inconsistent with their continued engagement in the securities business" (Pet. App. A38).[1]

ARGUMENT

The court below correctly upheld the Commission's findings as supported by substantial evidence, and the petition presents no question warranting further review.

1. *a.* Petitioners contend that the record does not support the Commission's finding (Pet. App. A18–25) that they violated Sections 5 (a) and (c) of the Securities Act by knowingly selling stock of Hamilton Life, a Michigan corporation for which they claimed an intrastate exemption from registration,[2] to nonresidents of Michigan. Section 3(a)(11) of the Securities Act exempts from registration "[a]ny security which is a part of an issue offered and sold only to persons resident within a single State * * *." The Commis-

[1] The Commission noted that, during the period involved in the instant proceedings, the registrant and Itin had also been fined and censured by the National Association of Securities Dealers "for failure to comply with our net capital and bookkeeping requirements and to disclose to customers that registrant was acting for both the buyer and seller, and for unlawfully extending credit to customers," and that this disciplinary action had been upheld by the Commission (Pet. App. A38–39).

[2] The person claiming an exemption has the burden of proving its availability. *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U.S. 119, 126; *Securities and Exchange Commission* v. *Culpepper*, 270 F. 2d 241, 246 (C.A. 2); *Gilligan, Will and Co.* v. *Securities and Exchange Commission*, 267 F. 2d 461, 466 (C.A. 2), *certiorari denied*, 361 U.S. 896. And the terms of an exemption are strictly construed against one seeking to rely on it. *Securities and Exchange Commission* v. *Sunbeam Gold Mines Co.*, 95 F. 2d 699, 701 (C.A. 9).

sion has long held that "* * * it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state. If any part of the issue is offered or sold to a nonresident, the exemption is unavailable * * *." Securities Act Release No. 4434, p. 2 (December 6, 1961).[3]

Petitioners' distribution scheme here was obviously not designed to insure that the entire Hamilton Life issue would come to rest in the hands of Michigan investors. As the court of appeals noted, petitioner Itin "actively sought orders for the stock, to be executed immediately after the commencement of trading of the stock, from nonresidents of Michigan" (Pet. App. A3); and the record shows that, at the very least, Itin solicited purchases of Hamilton Life stock, to take place after the initial distribution, from a number of persons not residents of Michigan (Tr. 1001–1007, 1046–1056, 2672, 3133–3135).[4]

These efforts were reflected in the fact that on the first three days of trading, purchases by nonresidents of Michigan constituted, on the average, more than half of the retail purchases of Hamilton Life stock (Div. Ex. 3420–3648, 7396). Registrant's high opening bid (fixed by Itin) of nearly double the offering price (Tr. 2918–2919, 2922–2923) tended, the Commission

[3] See *Hillsborough Investment Corp.* v. *Securities and Exchange Commission*, 276 F. 2d 665 (C.A. 1); *Securities and Exchange Commission* v. *Los Angeles Trust Deed and Mortgage Exchange*, 186 F. Supp. 830, 871 (S.D. Cal.), affirmed 285 F. 2d 162 (C.A. 9).

[4] "Tr." references are to the transcript of the administrative hearing; "Div. Ex." references are to the exhibits of the Commission's Division of Trading and Markets.

found, "* * * to induce residents, who had presumably purchased for investment, to sell their stock for a quick and substantial profit and enable registrant to resell the stock to nonresidents who had given it orders or indications of interest" (Pet. App. A22). In short, petitioners prevented the Hamilton Life shares from coming to rest exclusively in the hands of Michigan investors.

Moreover, during the initial offering of Hamilton Life shares, sales were made to nonresidents of Michigan for whom residents of that State were acting as nominees; and the court of appeals correctly held that there was substantial evidence to support the Commission's finding that Itin knew or should have known that the actual purchasers were nonresidents (see Tr. 431–440, 505–514, 3069–3072, 3092–3095, 3344–3345).

Petitioners also err in contending that the Commission's long-standing interpretation of the intrastate exemption "voids the exemption completely" (Pet. 14). Securities Act Release No. 4434, *supra* p. 5, makes clear that once the entire offering has come to rest, a later sale to a nonresident will not destroy the exemption. But the Commission and the courts have consistently rejected any *de minimus* rule, such as petitioners suggest, under which a few isolated interstate sales would not negate the exemption. See, *e.g.*, *Professional Investors, Inc.*, 37 S.E.C. 173, 175; *Associated Investors Securities Inc.*, 41 S.E.C. 160, 163–164; *Securities and Exchange Commission* v. *Hillsborough Investment Corp.*, 173 F. Supp. 86 (D. N.H.), affirmed, 276 F. 2d 665 (C.A. 1). This does not mean, as petitioners contend, that the Commission has sought

to make participants in an intrastate distribution "insurers" of all sales. The petitioners here were found to have deliberately created the situations which resulted in interstate sales, and the exemption was correctly held inapplicable.

b. Petitioners also contend that the court of appeals should have rejected the Commission's finding that the registrant and Hamilton Life were under common control and that the registrant, willfully aided and abetted by petitioner Itin, willfully violated Section 15(c)(1) of the Securities Exchange Act and Rule 15c1–5 thereunder by failing to disclose to purchasers of Hamilton Life such common control.[5]

Common control exists when "both corporations are controlled by individuals united by several factors tending to create and maintain a community of interest among them." *J. P. Morgan & Co., Inc.,* 10 S.E.C. 119, 136. The evidence of such community of interest in the instant case was overwhelming. The record shows that Itin and three principals of Hamilton Life came to Michigan with the purpose of forming that company (Tr. 2306, 2388, 2473, 2595); the three principals contributed 70 percent of the funds used to buy control of registrant (Tr. 2321–2324, 2391–2393, 2480–2485, 2688–2690); they sought a replace-

[5] Rule 15c1–5 (infra, p. 17) requires any broker or dealer "controlled by, controlling, or under common control with, the issuer of any security" to disclose the existence of such control to his customer at or before the completion of a transaction. The Rule was adopted pursuant to Section 15(c) which provides that "[t]he Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent."

ment for Itin when it appeared he might resign as registrant's president (Tr. 2336, 2416, 2504, 2652-2653); and two of these principals served as directors of registrant (Div. Ex. 7517) and one as sales manager (Tr. 2335–2336, 2349–2350).

Petitioners' disclosure of the common control relationship to the Commission, the Detroit Stock Exchange and the Michigan Corporation and Securities Commission (Pet. 19) satisfied neither the requirements nor the purpose of Section 15(c)(1) and Rule 15c1–5. The rule explicitly states that the disclosure must be made to the *customer* at or before the completion of the transaction. As the court below pointed out (Pet. App. A6):

> It is clear that the purpose of the Rule is to insure that customers know of any common control relationship which might affect the broker-dealer's objectivity about the stock. The purpose of the Rule is not served by saying that customers could determine that such a common control relationship existed by making a diligent search of certain public records. The Rule requires the broker-dealer to give written notice *to the customer*. [Emphasis in original.]

c. Petitioners also attack (Pet. 19–22) the court of appeals' affirmance of the Commission's finding that they willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Securities Exchange Act and the record keeping provision of Section 17(a) of the latter Act by mailing confirmations of purchase to persons who had not, in fact, agreed to purchase Wind-

sor Raceway stock.[6] The court noted that petitioners sent confirmations of sale, followed by telegrams demanding immediate payment, to those whose "indications of interest" petitioners had solicited, even though "* * * some had a slight interest in the stock but did not actually order any stock, and some had no interest in the stock but did not object to a salesman's suggestion that some stock be 'set aside' for them" (Pet. App. A9). The court agreed with the Commission's findings that this constituted fraudulent misrepresentations that the customers had entered into a binding contract to buy the stock.[7] The court left undisturbed the Commission's finding that registrant's entering upon its records such "sales" and cancellations of such sales for nonpayment constituted the making of false and fictitious entries. *Ibid.*[8]

---

[6] Petitioners, apparently, do not dispute the correctness of the holding that registrant willfully violated the antifraud provisions of the federal securities laws by reason of the unwarranted and extravagant price predictions made by its employees with respect to the stock of Hamilton Life (Pet. App. A4).

[7] See *R. A. Holman & Co., Inc.* v. *Securities and Exchange Commission*, 366 F. 2d 446, 451 (C.A. 2); *Shelley, Roberts & Company of California*, 38 S.E.C. 744, 751.

[8] Although the Commission based its finding of fraud on the alternative grounds that (1) indications of interest, standing alone, are not offers to purchase, and must be "firmed up" prior to sending a confirmation of sale; and (2) in any event, some of the persons to whom the confirmations and telegrams were sent clearly did not in fact agree to purchase the Windsor stock (Pet. App. A33–35), the court of appeals expressly found it unnecessary to pass on the validity of the Commission's first ground, and based its affirmance solely on the second ground (Pet. App. A9). Since the petition complains only of the Commission's first ground of decision (on which the court of appeals did not rely), it offers no reason for review of the court's holding on this issue.

2. Petitioners' claim (Pet. 8–13) that they were denied a fair hearing because they were not furnished the names and prehearing statements of prospective witnesses prior to the hearing. They were given this information immediately after the witnesses' direct testimony (Pet. App. A10), in compliance with the Commission's Rules of Practice, Rule 11.1, 17 CFR 201.1, and with the standards of the Jencks Act,[9] which the Commission follows in administrative proceedings. The courts have consistently held that there is no requirement that administrative agencies supply a respondent with an advance list of the witnesses or their statements prior to the close of the direct examination.[10]

Moreover, petitioners have not shown that they were prejudiced by the procedure employed. As the court below observed (Pet. App. A10), the hearing examiner advised counsel for petitioners at the beginning of the hearing that they could apply for a continuance whenever they felt they needed more time to examine a witness' prehearing statement (Tr. 6). And the Commission staff offered to provide counsel for each respondent with the names and prehearing statements of

[9] The Jencks Act, 18 U.S.C. 3500(a), provides in pertinent part that "no statement or report in the possession of the United States which was made by a Government witness or prospective Government witness (other than the defendant) to an agent of the Government shall be the subject of subpena, discovery, or inspection until said witness has testified on direct examination * * *."

[10] *Dlugash* v. *Securities and Exchange Commission*, 373 F. 2d 107, 110 (C.A. 2); *National Labor Relations Board* v. *Chambers Manufacturing Corporation*, 278 F. 2d 715 (C.A. 5); *National Labor Relations Board* v. *Vapor Blast Manufacturing Company*, 287 F. 2d 402 (C.A. 7).

each witness scheduled to be called the following day, so long as this information was not discussed with other counsel or the witnesses before they testified (Pet. App. A36). Petitioners' counsel refused this offer, although it was accepted by counsel for another respondent (Tr. 142–143). The extensive and searching cross-examination conducted by counsel for petitioners shows that they were not handicapped, and they complain of no instance when they sought but were denied additional time after the statements were supplied.

Petitioners err in contending (Pet. 10–11) that, had this been a criminal proceeding in a federal district court, Rule 16 of the Federal Rules of Criminal Procedure would have compelled the government to provide the discovery they sought.[11] Rule 16(b) explicity states that the rule "* * * does not authorize the discovery or inspection * * * of statements made by government witnesses or prospective government witnesses (other than the defendant) to agents of the government except as provided in 18 U.S.C. § 3500." Petitioners' reliance (Pet. 10) on *Brady* v. *Maryland*, 373 U.S. 83, is also misplaced, since that decision involved the suppression of evidence rather than the timing of its disclosure.

[11] The procedure in *United States* v. *Wolfson*, 289 F. Supp. 903 (S.D.N.Y.), a criminal case, is not inconsistent with that employed here since there the court granted defendants' motion for discovery of certain papers only because the government had furnished similar information to another defendant and fairness required the same treatment of the movant defendants.

3. The sanctions imposed (*supra*, pp. 2–3) were a proper exercise of the Commission's discretion, as the court of appeals held (Pet. App. A10–11).[12] The Commission found that petitioners had committed "extensive violations" that demonstrated "gross indifference" to the securities laws (Pet. App. A38) in willfully selling unregistered securities, mailing false confirmations, failing to disclose the common control between registrant and an issuer, keeping false records and making fraudulent and deceptive price predictions. See, also, *supra*, n. 1.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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Associate General Counsel,
THEODORE SONDE,
Assistant General Counsel,
Securities and Exchange Commission.

JUNE 1970.

[12] Petitioners do not claim that the sanctions were not legally authorized.

APPENDIX

Securities Act of 1933

Section 3 (a)(11), 15 U.S.C. 77c(a)(11)

EXEMPTED SECURITIES

SEC. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * * * *

(11) Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.

* * * * *

Section 5 (a), (c), 15 U.S.C. 77e (a), (c)

PROHIBITIONS RELATING TO INTERSTATE COMMERCE AND THE MAILS

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

* * * * *

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

* * * * *

Section 17(a), 15 U.S.C. 77q(a)

FRAUDULENT INTERSTATE TRANSACTIONS

SEC. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

* * * * *

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. 78j(b)

MANIPULATIVE AND DECEPTIVE DEVICES

SEC. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumen-

tality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * * * *

Section 15(c), 15 U.S.C. 78o(c)

(c)(1) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

* * * * *

Section 17(a), 15 U.S.C. 78q(a)

ACCOUNTS AND RECORDS, REPORTS, EXAMINATIONS OF EXCHANGES, MEMBERS AND OTHERS

SEC. 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records,

and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

* * * * *

Rules Under the Securities Exchange Act of 1934

Rule 10b–5, 17 CFR 240.10b–5:

RULE 10B–5. EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

RULE 15C1–2. FRAUD AND MISREPRESENTATION

(*a*) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act * * *, is hereby defined to include

any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(*b*) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(*c*) The scope of this rule shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15(c)(1) of the Act.

Rule 15c1–5. Disclosure of Control

The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act, is hereby defined to include any act of any broker or dealer controlled by, controlling, or under common control with, the issuer of any security, designed to effect with or for the account of a customer any transaction in, or to induce the purchase or sale by such customer of, such security unless such broker or dealer, before entering into any contract with or for such customer for the purchase or sale of such security, discloses to such customer the existence of such control, and unless such disclosure, if not made in writing, is supplemented by the giving or sending of written disclosure at or before the completion of the transaction.

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